No. 83-950

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

MICHAEL E. MOSS,
Petitioner,

v.

JAMES M. NEWMAN,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF IN OPPOSITION FOR RESPONDENT JAMES M. NEWMAN

ARTHUR F. MATHEWS *
ANDREW B. WEISSMAN
WILMER, CUTLER & PICKERING
1666 K Street, N.W.
Washington, D.C. 20006
(202) 872-6000
Attorneys for Respondent

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

1. Did the Court of Appeals err in concluding that open-market sellers of securities who had no previous relationship of any type with purchaser have no private claim for relief under Section 10(b) of the Securities Exchange Act of 1934 for the purchaser's failure to disclose material non-public information allegedly misappropriated from a third party?

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BRIEF IN OPPOSITION FOR RESPONDENT JAMES M. NEWMAN

Respondent James M. Newman submits this brief in opposition to the petition for writ of certiorari.

STATEMENT OF THE CASE

According to the allegations in petitioner's Amended Complaint,[1] on November 30, 1976, petitioner sold 5,000

[1] In his brief, petitioner sets forth facts that go well beyond the allegations in the Amended Complaint, which is all that should be at issue in any review of the Court of Appeals' affirmance of the District Court's dismissal pursuant to respondent's motion to dismiss under Fed. R. Civ. P. 12(b)(6). Petitioner has even

shares of common stock of the Deseret Pharmaceutical Company ("Deseret") on the open market at approximately $28 per share. (App. 3a.)[2] On the same day, respondent purchased Deseret common stock on the open market (App. 6a), while allegedly in possession of material non-public information regarding an impending tender offer by the Warner-Lambert Company ("Warner") for Deseret.[3] There is no allegation that respondent purchased petitioner's specific shares. Respondent is alleged to have become aware of the impending tender offer as part of an arrangement by which an employee of the investment banking firm of Morgan Stanley & Co. Inc. ("Morgan Stanley") leaked information of potential tender offers to respondent and others through a third party. (App. 5a-6a.) Respondent and others have been convicted of crimes committed in the course of furthering this scheme on the theory that they defrauded Morgan Stanley by misappropriating confidential information from Morgan Stanley for use in the purchase of securities.[4]

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neglected to include in his Appendix a copy of the Amended Complaint, which we provide in the Appendix to this Opposition. This Court should not construe respondent's failure to dispute much of petitioner's Statement of Facts as an admission of its accuracy. Regardless of whether those allegations are true, petitioner's claim must stand or fall on the facts alleged in the Amended Complaint and we therefore focus our discussion, as did the lower courts, on those allegations.

[2] As used herein, "App." refers to the appendix provided by respondent at the back of this submission and "Pet. App." refers to the appendix included in petitioner's submission.

[3] Warner in fact publicly announced a tender offer for Deseret stock at $38 per share on December 7, 1976. (App. 6a.)

[4] *See United States v. Newman*, 664 F.2d 12, 15 n.1 (2d Cir. 1981), *aff'd after remand*, Docket No. 82-1273 (2d Cir. Feb. 8, 1983) (unpublished order), *cert. denied*, 52 U.S.L.W. 3266 (U.S. Oct. 4, 1983) (No. 82-1653) (Court of Appeals explicitly refuses to consider any theory of the Government based on fraud on shareholders because indictment was based on theory of fraud on Morgan Stanley).

The District Court granted respondent's motion to dismiss, relying heavily on this Court's decision in *Chiarella v. United States*, 445 U.S. 222 (1980), and the Second Circuit's decision in *United States v. Newman*, 664 F.2d at 12. The Court referenced particularly this Court's statement in *Chiarella* that: "[T]he element required to make silence fraudulent—a duty to disclose—is absent in this case. No duty could arise from petitioner's relationship with the sellers of the target company's securities, for petitioner had no prior dealings with them." (Pet. App. 40a, quoting 445 U.S. at 232.) The District Court concluded that "[t]he Supreme Court argument compels a finding that Newman . . . cannot be liable to plaintiff for a violation of Section 10(b)." (Pet. App. 40a.) The Court also noted that the Second Circuit's decision in *Newman* that a *criminal* violation of Section 10(b) "can be based on the breach of a duty owed to the acquiring corporation or other party even though no duty is owed to the issuer" is inapposite to plaintiff's case because the key issue of respondent's relationship to plaintiff or other selling shareholders was of no consequence to the *Newman* Court. (Pet. App. 41a.)

The Court of Appeals, which had the advantage of further guidance from this Court in *Dirks v. SEC*, 77 L.Ed.2d 911 (1983), affirmed the judgment and reasoning of the District Court. After noting the holding of *Chiarella* that fraud under Section 10(b) for nondisclosure requires " 'a relationship of trust and confidence between parties to a transaction' " (Pet. App. 13a, quoting 445 U.S. at 230), Judge Meskill concluded that "like Chiarella and Dirks, the defendants were 'complete stranger[s] who dealt with the sellers [of Deseret stock] only through impersonal market transactions.' " (Pet. App. 20a, paraphrasing 445 U.S. at 232-33.) The Court expressly rejected the argument that this result was inconsistent with its decision in *Newman*, stating that: "Nothing in our opinion in *Newman* suggests that an

employee's duty to 'abstain or disclose' with respect to his employer should be stretched to encompass an employee's 'duty of disclosure' to the general public." (Pet. App. 15a.)

ARGUMENT

Petitioner raises only one narrow ground for granting a writ of certiorari in this case: the application of the so-called "misappropriation" theory of "insider" trading to the peculiar facts of his cause of action. Contrary to petitioner's claim (at p. 10), the petition does not in any respect present the "misappropriation" issue left undecided in *Chiarella*. The law of the Second Circuit is that the undisclosed use of material nonpublic misappropriated information *does* constitute a violation of Section 10(b) of the 1934 Act—a rule of law of which petitioner does not and cannot seek review here. Petitioner merely presents the narrower question of his standing to sue for damages under Section 10(b) even though he was not the party defrauded by the misappropriation.

The District Court and the Court of Appeals treated this case exactly as is required by this Court's decisions in *Chiarella* and *Dirks*. Since petitioner's claim of fraud is based wholly on respondent's nondisclosure of information, each court examined petitioner's allegations to determine whether the requisite "relationship of trust and confidence" was alleged to exist between the plaintiff and defendants. *See* 445 U.S. at 230; 77 L.Ed.2d at 922. Finding that petitioner and respondent were "complete strangers," [5] the courts quite properly concluded that pe-

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[5] Petitioner has not sought review of the lower courts' rejection of the alternative ground he pursued below that Morgan Stanley and its employee should be considered "insiders" because Morgan Stanley had negotiated with Deseret on behalf of Warner. In any event, the Court of Appeals properly noted that facts supporting this theory were not included in the Amended Complaint (Pet. App. 16a), and correctly rejected the theory as inconsistent with the Second Circuit's earlier decision in *Walton v. Morgan Stanley & Co.*, 623 F.2d 796 (2d Cir. 1980) (cited with approval in *Dirks v. SEC*, 77 L.Ed.2d at 927 n.22).

titioner was not "defrauded," and therefore that petitioner was not someone who could properly bring a private action under Section 10(b) for fraud.[6]

In sum, the Court of Appeals was correct when it concluded that "[i]n essence, Moss' theory is that any person who 'misappropriates' information owes a general duty of disclosure to the entire marketplace." (Pet. App. 21a.) This theory is in direct conflict with this Court's decisions in *Chiarella* and *Dirks* expressly rejecting the proposition that a duty of disclosure of material nonpublic information is owed to the marketplace regardless of the absence of any special relationship between the purchaser and seller. *See* 445 U.S. at 232-33; 77 L.Ed.2d at 921-22. The decisions below faithfully adhered to this standard.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

ARTHUR F. MATHEWS *
ANDREW B. WEISSMAN
WILMER, CUTLER & PICKERING
1666 K Street, N.W.
Washington, D.C. 20006
(202) 872-6000
Attorneys for Respondent

* Counsel of Record

January 6, 1984

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[6] The lower courts did not, of course, address the question whether other private parties, *e.g.*, Morgan Stanley or its clients, would have standing to claim damages in a private action under Section 10(b) in connection with any purchase or sale of securities made by them. Accordingly, it is hardly accurate to suggest, as petitioner does (at p. 14), that the lower court decisions leave persons like respondent "immunized from civil liability."

APPENDIX

APPENDIX

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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82 Civ. 5182 (MP)

MICHAEL E. MOSS,

Plaintiff,

—against—

MORGAN STANLEY INC., E. JACQUES COURTOIS, JR., ADRIAN ANTONIU, and JAMES M. NEWMAN,

Defendants.

AMENDED COMPLAINT

CLASS ACTION

JURY TRIAL DEMANDED

Plaintiff, by his attorneys, Kaplan, Kilsheimer & Foley and Kohn Milstein Cohen & Fausfeld, as and for a complaint against defendants, alleges the following:

JURISDICTION AND VENUE

1. Defendants have engaged in acts, practices and courses of conduct which constitute violations of Sections 10(b) and 14(e) of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. § 78j(b) and 78n(e)), Rules 10b-5 and 14e-3 (17 C.F.R. 240. 10b-5 and 204. 14e-3) promulgated thereunder, Section 20(a) of the Exchange Act, 15 U.S.C. § 78(a), 18 U.S.C. §§ 1962, 1964 and common law principles.

2. This Court has jurisdiction of this action pursuant to Section 27 of the Exchange Act (15 U.S.C. § 78aa),

Section 901(a) of Title IX of the Organized Crime Control Act of 1970, otherwise known as Racketeer Influenced and Corrupt Organizations ("RICO"), 18 U.S.C. §§ 1964 (c), 1965, and principles of pendent jurisdiction.

3. Each of the defendants currently is found in and/or transacts business within the Southern District of New York, or, at the time of the commission of the acts alleged hereunder was found in or transacted business in the Southern District of New York. Acts and transactions constituting violations of the Exchange Act have, as described herein, occurred within the Southern District of New York. While engaged in the acts and practices described herein, defendants directly and indirectly made use of the mails and means and instruments of transportation and communication in interstate commerce.

CLASS ACTION ALLEGATIONS

4. This action is brought as a class action by plaintiff under Rule 23(b)(3) F.R.C.P. The class represented by plaintiffs includes all persons who sold stock of Deseret Pharmaceutical Company ("Deseret") on November 30, 1976 ("the period"). During the period, more than 100,000 shares of Deseret common stock were traded on the New York Stock Exchange ("NYSE").

5. The class is estimated to consist of hundreds of members and its individual members can be ascertained from transfer records or from records of broker dealers. Joinder of all class members is impracticable. There are questions of law and fact common to the class which plaintiff seeks to represent.

6. The claims of plaintiff are typical of the claims of the class which he seeks to represent. Plaintiff will fairly and adequately protect the interests of the plaintiff class. Plaintiff sold his shares of Deseret during the time period described for the class. Plaintiff does not have any interest which is antagonistic to the plaintiff class. Counsel for plaintiff are experienced in class action litigation.

7. This Court should permit this action to be maintained as a class action pursuant to Rule 23, Fed.R.Civ.P., based on an appropriate finding under subdivision (b) (3) that the questions of law and fact predominate over any question affecting only individual members and a class action is superior to other available methods for efficient adjudication of the causes of action for the following reasons:

(a) The members of the class do not appear to have any interest in individually controlling the prosecution of separate actions. Plaintiff is not aware of any other pending litigation relating to this matter.

(b) Plaintiff, and most other members of the class, will not be able to obtain legal redress unless the action is maintained as a class action.

(c) It is desirable that these claims be litigated in the Southern District of New York since the principal offices of the corporate defendant are in this district and the wrongful transactions occurred here.

(d) There are no difficulties of class management in this suit since the suit is brought in the judicial district where (1) the plaintiff resides; (2) the corporate defendant's principal offices are located, and (3) the wrongs occurred. Furthermore, the members of the class are ascertainable and there should be no problem in providing them with notice of this suit.

PARTIES

8. Plaintiff Michael E. Moss sold 5,000 shares of Deseret common stock on November 30, 1976 at approximately $28.00 per share.

9. Defendant Morgan Stanley & Co. Inc. ("Morgan Stanley") is a corporation with its principal office at 1251 Avenue of the Americas, New York, New York. Morgan Stanley, a broker dealer and an investment

banker, rendered advice and assistance to Warner-Lambert Company ("Warner") for a tender offer by it for Deseret stock.

10. Defendant E. Jacques Courtois, Jr. ("Courtois") was employed by Morgan Stanley during November 1976. Upon information and belief, he has since removed himself from the United States and now resides in Bogata, Colombia.

11. Defendant Adrian Antoniu ("Antoniu") currently resides in Milan, Italy and is employed with the firm of Egon Zehnder International, an international executive search firm in Milan, Italy. Antoniu was employed by Morgan Stanley in 1972-1974 as an investment banker. During November 1976, he was employed by Kuhn Loeb & Co., a broker dealer and an investment banker with offices in this district.

12. Defendant James M. Newman ("Newman") currently resides in Demarest, New Jersey. During November 1976, Newman was a stock broker in New York, New York.

COUNT I.

Plaintiffs' Claim For Relief Under Sections 10(b), 14(e) and 20(a) Of The Exchange Act, Rules 10b-5 and 14e-3 and Common Law Principles

13. For a long period of time prior to November 1976, there had been an on going scheme and conspiracy among Courtois, Antoniu, Newman and others pursuant to which inside information concerning planned tender offers for which Morgan Stanley was performing brokerage or investment banking services was illegally and prematurely disclosed and utilized. Among other matters, the illegal scheme and conspiracy included the tipping of information known to Courtois, Antoniu, Newman and Morgan Stanley but not known to the investing public and the use of that non-public information to trade in stocks for which a tender offer was expected or probable.

14. On or about November 23, 1976, Warner engaged the services of Morgan Stanley, in its capacity as an investment banker, to advise and assist Warner in its effort to acquire control of Deseret. Morgan Stanley was to investigate Deseret, evaluate its stock and recommend a price for Warner to offer Deseret shareholders in a tender offer.

15. At all times during the course of its engagement by Warner, Morgan Stanley knew that all information pertaining to Warner's plan to take over Deseret was to be regarded as privileged and confidential especially since the price at which Warner would offer to purchase Deseret stock would be and was substantially higher than current market prices for Deseret. Morgan Stanley had reason to know that the premature disclosure of any such information to third parties was unlawful since such premature disclosure, might cause persons who learned such information to purchase Deseret stock and would be detrimental to persons who sold Deseret stock without knowledge that Warner would offer shortly to purchase Deseret stock at a higher price.

16. Morgan Stanley permitted defendant Courtois to gain knowledge of and obtain access to confidential and privileged information pertaining to Warner's planned offer for Deseret stock. At all times during November 1976, Courtois was employed by Morgan Stanley in its merger and acquisition department and was under the supervision and control of Morgan Stanley.

17 On or about November 30, 1976, Courtois disclosed to defendant Antoniu privileged and confidential information, obtained in the course of Courtois' employment at Morgan Stanley, pertaining to Warner's plan to acquire Deseret stock. Courtois disclosed this information as part of a continuing conspiracy with the expectation that Antoniu and other conspirators would use the information to illegally trade in Deseret stock. At the time of the said disclosure, Antoniu was an outsider and would

not otherwise have been privy to the information disclosed to him by Courtois.

18. On November 30, 1976, Antoniu, as part of the continuing scheme and conspiracy disclosed the confidential inside information about the planned Warner offering for Deseret to Newman. Newman, a stock broker, acting on the inside information obtained from Antoniu, and as a part of the continuing scheme and conspiracy, advised certain of his customers to buy Deseret stock in anticipation of Warner's tender offer for Deseret and purchased Deseret stock for his own account and others. Thus, Newman, his customers and others purchased Deseret stock on November 30, 1976 at prices substantially below the price offered by Warner shortly thereafter.

19. For example, on November 30, 1976, Newman called one of his customers, Bruce Steinberg, and advised him to purchase Deseret stock immediately. Steinberg, following Newman's recommendations, did purchase Deseret stock on that day. Upon information and belief there are other persons, presently not known to plaintiff, who were similarly informed by Newman on November 30 that they should buy Deseret stock, and who did buy Deseret stock. Newman's recommendations with respect to Deseret stock was based upon illegally obtained nonpublic information as set forth hereinabove.

20. The volume of shares of Deseret stock traded on the NYSE increased from about 5,000 shares on November 29, 1976 to more than 143,000 shares on November 30, 1976. Trading in Deseret stock was halted after November 30 at the request of the NYSE and was not resumed until December 7, 1976 after the Warner tender offer had been publicly announced. In its tender offer, Warner offered to and did purchase Deseret stock at $38 per share which was substantially higher than the prices received by plaintiff and members of the class on November 30.

21. Defendant Courtois learned about the proposed tender offer by Warner for Deseret during the course of his employment at Morgan Stanley and disclosed the confidential non-public information while he was employed by Morgan Stanley.

22. Defendants Courtois, Antoniu and Newman conspired to and did violate the law. These defendants illegally and intentionally disclosed and utilized to their personal advantage privileged and confidential inside information, as set forth above, and intentionally and knowingly defrauded plaintiff and class members who sold their shares of Deseret stock at prices substantially below that offered by Warner in its tender offer which was subsequently announced.

23. Morgan Stanley aided and abetted Courtois, Antoniu and Newman in this conspiracy and in these violations of the law. Accordingly, Morgan Stanley is jointly and severally liable for the damages suffered by plaintiff and class members. Also, Morgan Stanley failed to adequately supervise Courtois during the course of his employment and recklessly and negligently failed to take steps to insure that the confidential information concerning Warner's proposed tender offer would not be disclosed outside of Morgan Stanley. Morgan Stanley is also jointly and severally liable for the damages suffered by plaintiff and other members of the class as a control person (15 U.S.C. § 78t) and under the common law principles of *respondeat superior*.

24. The above described conduct constituted a scheme to defraud plaintiff and each member of the class in violation of Sections 10(b) and 14(e) of the Exchange Act (15 U.S.C. §§ 78j(b) and 78n(e), Rules 10(b)-5 and 14(e)-3 promulgated thereunder, and common law principles.

25. Plaintiff and other members of the class have been substantially damaged in that they sold Deseret stock prior to the public announcement of the Warner tender offer at prices substantially below that offered by Warner.

COUNT II.

Plaintiff's Claim for Relief
For Violations of RICO

26. Paragraphs 1 through 25 of this Complaint are incorporated herein by reference and realleged as though fully set forth.

27. Defendants' actions as set forth herein in this Complaint constitute at least two acts of fraud in connection with the purchase and sale of securities and as such represent a pattern of racketeering activity within the meaning of RICO.

28. As a result of defendant's RICO violations, plaintiff and the class should be awarded treble damages for the losses they sustained.

COUNT III.

Plaintiff's Claim For Relief
For Violations of The Common Law

29. Paragraphs 1 through 25 of this Complaint are incorporated herein by reference and realleged as though fully set forth.

30. The jurisdiction of this Court as to Count III is founded on the principles of pendent jurisdiction.

31. The claims alleged in Count III herein arise under the applicable principles of the common law. The unlawful acts committed by defendants as set forth above constitute violations of the applicable principles of common law fraud. Furthermore, defendant Morgan Stanley is liable under the doctrine of *respondeat superior.*

WHEREFORE, plaintiff demands:

(a) damages jointly and severally against the defendants, together with appropriate interest, treble damages for the claims under RICO, and punitive damages for the common law claims;

(b) costs and expenses of this action, including reasonable attorneys' fees, and the costs of experts; and

(c) such other and further relief as the Court may deem just.

Dated: New York, New York
August 30, 1982

KAPLAN, KILSHEIMER & FOLEY

By: /s/ [Illegible]
122 East 42nd Street
(212) 687-1980

—and—

KOHN MILSTEIN COHEN & HAUSFELD
1776 K Street, N.W.
Washington, D.C. 20006
(202) 293-7110

Attorneys for Plaintiff